



June 2006

Legislative Audit Division

State of Montana

Report to the Legislature

Performance Audit

The Northern Rockies Consortium for Space Privatization at The University of Montana

The Office of the Vice President for Research and Development
The University of Montana

This report contains findings and recommendations developed as a result of a performance audit of the activities of the Northern Rockies Consortium for Space Privatization at The University of Montana. Findings and recommendations address improvements in the university's internal controls over sponsored research programs and related technology transfer activities.

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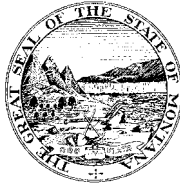
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June 2006

The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit of the Northern Rockies Consortium for Space Privatization (NRCSP) at The University of Montana (UM). This report includes background information on the development of the NRCSP program and findings and recommendations addressing improvements in management controls at UM. A written response from the Office of the Commissioner of Higher Education and The University of Montana is included at the end of the report.

We wish to express our appreciation to UM faculty and staff and others for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Scott A. Seacat

Scott A. Seacat
Legislative Auditor

Legislative Audit Division

Performance Audit

The Northern Rockies Consortium for Space Privatization at The University of Montana

**The Office of the Vice President for Research and Development
The University of Montana**

Members of the audit staff involved in this audit were Angus Maciver
and Diedra Murray.

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Appointed and Administrative Officials

The University of Montana

George Dennison, President

Daniel Dwyer, Vice President for Research and Development

Robert Duringer, Vice President for Administration and Finance

Teresa Branch, Vice President for Student Affairs

David Aronofsky, Legal Counsel

Commissioner of Higher Education

Sheila Stearns, Commissioner of Higher Education

Introduction

The Legislative Audit Committee prioritized a performance audit of research and development and technology transfer activities in the Montana University System for the 2007 biennium. During audit work, concerns were identified regarding the activities of the former Vice President for Research and Development (VPRD) at The University of Montana (UM). Specifically, questions were raised regarding the activities of the Northern Rockies Consortium for Space Privatization (NRCSP) at UM. The NRCSP was a sponsored research program funded through a grant from the National Aeronautics and Space Administration (NASA). At the request of the Commissioner for Higher Education, we performed additional audit work to address the activities of the former Vice President, the NRCSP, and the primary grant sub-contractor, the Inland Northwest Space Alliance (INSA).

The Northern Rockies Consortium for Space Privatization

The NRCSP was a sponsored research program initiated during the tenure of the former VPRD. UM pursued funding for NRCSP through a direct congressional appropriation (earmarked funding). Appropriations were directed to space privatization and education efforts at the university and the total amount appropriated was \$4.05 million. Of this total, \$3.3 million was intended to fund activities under the NRCSP grant and the remaining \$750,000, was directed towards a separate space education effort. INSA became the primary sub-contractor for the NRCSP grant effective July 1, 2003. Up to and following this date, several members of UM staff from within the office of the VPRD resigned to take up positions with INSA, or subsequently went on to receive compensation from INSA in some form.

Audit Issues Identified During Review of NRCSP Activities

Concerns relating to the NRCSP grant and the role of INSA, included whether the program fulfilled its original mission and whether the grant was managed correctly by UM. Audit work addressed these issues and findings show improvements are necessary in grant management procedures.

NRCSP Statement of Work and Mission Fulfillment

Although originally developed as a ‘space privatization’ program, the joint efforts of the NRCSP and INSA do not appear to have

Report Summary

significantly furthered the commercialization of space-related technologies in the region. However, for the majority of the activities outlined in the statement of work, there is evidence that NRCSP delivered in line with the educational and outreach expectations of NASA.

Federal Earmarks and Sponsored Research

Earmarked federal awards are subject to review by federal agencies to ensure the proposed purposes are consistent with the agency's mission. This differs from competitive peer review, which assesses merit from an entirely different perspective. The lack of a competitive selection process for earmarked federal grants should serve as an indicator of potential risk and the need for elevated scrutiny of these activities. The issue of federal earmarking is applicable to all of Montana's institutions of higher education and further discussion of controls over earmarked federal funding will be included in a subsequent report addressing system-wide issues.

UM Should Improve Management of Sponsored Research Activities

In some regards the NRCSP program and the establishment of INSA were a unique circumstance. However, the uniqueness of these circumstances also serves as an indicator of the potentially high level of risk involved in these activities. Mitigating this risk should have been a priority for university administrators, but our review shows several opportunities to do so were missed. The university, either by action or omission, failed to ensure a sufficient level of control was exercised over activities relating to the NRCSP grant.

UM Disclosure Documentation Should be Revised

Potential conflicts of interest with the NRCSP grant existed because several members of staff within the office of the Vice President for Research and Development (VPRD) went on to work for INSA. Disclosure of these conflicts was not documented within the office of the VPRD. Revising UM proposal clearance documentation to directly address potential conflicts for all relevant individuals could ensure officials responsible for grant oversight and compliance are notified of any potential conflicts. As a counterpart to notification, UM should also ensure the management of potential conflicts is adequately documented.

UM Conflict Management Procedures Should be Improved

Properly documenting potential conflicts of interest is one important element of disclosure and helps reduce the perception of partiality. Another necessary element is independent review of conflict management. UM conflict management procedures assign this role to the office of the VPRD, which is responsible for ensuring potential conflicts are reviewed and managed effectively. In situations where members of staff within the office of the VPRD are directly involved in research activities, disclosure of potential conflicts of interest should be managed independently.

Board of Regents Review of NRCSP Activities

Depending on statutory interpretation, the NRCSP research effort could have been subject to Board of Regents oversight. However, criteria available to universities regarding what constitutes a research and development program could be clarified further. Development of such criteria could assist universities in determining which research efforts require board approval. This issue will be addressed in more detail in a subsequent report containing findings applicable to the Montana University System.

Board of Regents approval is required before university employees can be employed by business entities seeking to commercialize intellectual property developed through research activities. The formation of INSA was similar to technology transfer activities and UM should have sought board review. UM confirmed the university did consider seeking board review, but subsequently decided this was unnecessary. The decision by the UM President's office not to externally disclose INSA formation meant the exemptions from state ethics laws normally available for technology transfer activities were not applicable. Certain provisions of the ethics code could be relevant to the formation of INSA. In accordance with our statutory obligations to report potential violations of state laws, we have made referrals to the relevant offices in relation to NRCSP activities.

Disclosure of Lobbying Activities

Federal laws and regulations establish restrictions on lobbying activities for recipients of federal grants, contracts, cooperative agreements and other awards/assistance. Lobbying reports filed with the United States Senate show the Inland Northwest Space Alliance

Report Summary

(INSA) used the lobbying services of Washington D.C.-based lobbying firm during 2004 and 2005. To date, INSA has not submitted a lobbying activity disclosure form to UM relative to the NRCSP grant. To comply with federal law and regulations, UM should require disclosure of lobbying activity for lower-tier sub-recipients where the contract cost is in excess of \$100,000.

Contract Monitoring Procedures

For the NRCSP grant, some portions of the scope of work assigned to INSA were conducted by a private technology company based in Washington, D.C. under a sub-contract. Where a lower-tier sub-contractor is not identified in the original proposal, the sub-recipient must seek authorization from the grantor agency prior to executing a contract. Review of the NRCSP grant file and sub-recipient records for INSA showed no documentation was included indicating the university had verified grantor agency approval of the sub-contract. Taking steps to verify and document pre-approval of sub-contracts could help protect the university from liability associated with improper payments to lower-tier sub-contractors.

Monitoring of Contracted Services

INSA also entered into consulting services agreements (defined as agreements for contracted services for administrative purposes). These agreements were with a Missoula-based consulting firm and an attorney based in Washington, D.C. Review of INSA records showed limited information was available regarding vendor selection procedures or the scope of work assigned to the consultants. Under Office of Management and Budget circular A-133, UM is required to have sub-recipient monitoring procedures in place to ensure lower-tier entities are complying with relevant laws and regulations. For INSA, these procedures included review of the organization's financial statements audit and other measures, but did not include review of procurement policies. For nongovernmental sub-recipients, the university should revise monitoring procedures to ensure compliance with federal procurement standards for competitive bidding and sole source exceptions.

Chapter I - Introduction

Introduction

The Legislative Audit Committee prioritized a performance audit of research and development and technology transfer activities in the Montana University System for the 2007 biennium. During the course of audit work, concerns were identified regarding the activities of the former Vice President for Research and Development (VPRD) at The University of Montana (UM). Specifically, questions were raised regarding the activities of the Northern Rockies Consortium for Space Privatization (NRCSP) at UM. The NRCSP was a sponsored research program funded through a grant from the National Aeronautics and Space Administration (NASA). At the request of the Commissioner for Higher Education, we performed additional audit work to address the activities of the former Vice President, the NRCSP, and the primary grant sub-contractor, the Inland Northwest Space Alliance (INSA). INSA is an independent, nonprofit corporation and was responsible for conducting some of the work included in the NRCSP grant.

Audit Reporting

Audit work in relation to the activities of the former Vice President and the NRCSP was conducted within the scope of the original audit. However, we determined a separate report would be necessary to address audit findings in the context of the specific circumstances. This report contains findings and recommendations relevant solely to this situation and related management issues at UM. A subsequent report will include findings and recommendations applicable within the broader scope of the original performance audit and relevant to all institutions within the Montana University System.

Audit Objectives

Our original audit objectives included methodologies addressing compliance with federal, state and university laws, policies and procedures guiding research and development programs. Following the decision to expand audit work, we developed the following single audit objective in relation to the activities of the former VPRD and the NRCSP.

- ▶ Determine if sponsored research activities involving the former Vice President for Research and Development at UM were

Chapter I - Introduction

conducted in compliance with federal and state law, and Board of Regents and university policies and procedures.

Audit Scope

Audit scope focused on NRCSP activities and other research programs where the former VPRD was directly involved. We also identified additional UM staff members involved with the NRCSP and included their activities within the scope. All of the sponsored research activities included in our review occurred between 1997 and 2005. Relevant documentation reviewed at UM related primarily to sponsored research funded through grants from the federal government. Specific emphasis was placed on grants funded through NASA.

Audit Methodologies

We reviewed federal and state laws relating to research and development, and federal compliance standards for research grants. We also obtained and reviewed Montana Board of Regents and UM policies and procedures relating to sponsored research programs, grant administration and financial issues, and managing conflicts of interest. Interviews were conducted with senior UM administrative staff within the office of the VPRD, the Office of Research and Sponsored Programs, and the President's Office. We also conducted interviews with INSA staff and federal government officials.

We reviewed twelve grant files to ensure the required documentation was included and the relevant procedures were followed during administration of the grants. These grants were funded through eight different federal or state agencies and were awarded for a combined amount of approximately \$3.8 million.

Additional federal and UM documentation relating to the NRCSP grant and INSA were also obtained and reviewed. These documents included records of the federal appropriations made to UM for NRCSP activities; proposals, contracts, and communications between UM and NASA; corporate and financial records from INSA; documents accessed during the internal UM review/audit of the activities of the former Vice President; UM financial data; and UM employment records.

Report Organization

Remaining chapters of this report contain background information relating to the activities of the former VPRD and the NRCSP, and findings relating to improvements in UM management controls.

Chapter II - Background Information

Introduction

This chapter outlines background information relating to the sponsored research process and the organization and staffing of the office of the Vice President for Research and Development (VPRD) at The University of Montana (UM). We also include a narrative outlining development of the grant funding proposal for the Northern Rockies Consortium for Space Privatization (NRCSP), the decision to assign the Inland Northwest Space Alliance (INSA) as primary grant sub-recipient, movement of personnel between UM and INSA, subsequent administration of the grant, and the use of federal earmark funds for sponsored research.

Sponsored Research Process

Sponsored research refers to those activities within universities where external agencies or organizations fund academic research activities. The most common form of funding for sponsored research is grant-based and the most common funding sources are federal government agencies. Other funding sources include state government, private companies, nonprofit institutions or organizations, and other institutions of higher education. Throughout this report we use the term grant to refer generically to UM grants, cooperative agreements and other awards funding sponsored research.

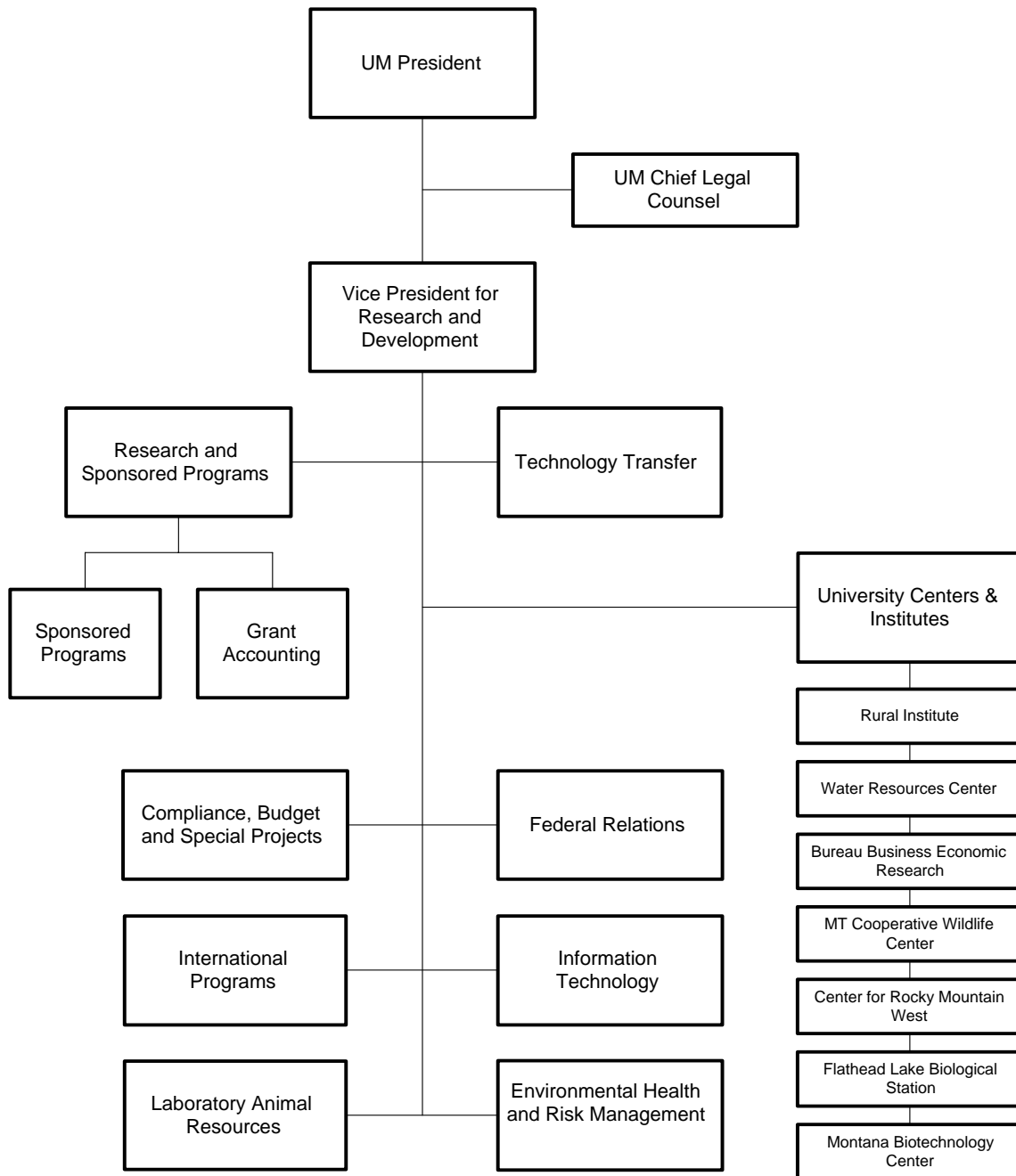
University faculty submit proposals to grantor agencies, usually in response to requests or knowledge of available funding. If the research proposal is successful, the university enters into a grant agreement with the funding agency. The faculty or staff member responsible for leading the research is referred to as the Principal Investigator (PI). As well as conducting the research work, the PI is responsible for grant administration tasks. Grant funds are normally received by universities on a reimbursement basis following expenditure of funds.

Organization of the Office of the VPRD

Research and development functions at UM are administered through the office of the VPRD. The following chart illustrates the organizational structure of UM research and development functions.

Chapter II - Background Information

Figure 1
Organizational Structure of Research and Development Functions
At The University of Montana



Source: Compiled by the Legislative Audit Division from university records.

Chapter II - Background Information

The VPRD reports directly to the UM President and can also refer to the advice of UM Legal Counsel. For the research and development process, the two most important functions overseen by the VPRD are the Office of Research and Sponsored Programs (ORSP) and the Technology Transfer function. Each of these functions is overseen by an Associate Vice President reporting to the VPRD. The ORSP consists of two different functions. The Sponsored Programs unit assists faculty in developing grant proposals and budgets, negotiates and processes awards, and manages non-accounting functions after a grant is received. The Grant Accounting unit provides administrative review of grant expenditures and manages payments after the grant has been awarded. The Technology Transfer function is responsible for activities associated with commercialization of university research and collaboration with private sector organizations working with university researchers.

VPRD Current Staffing

This audit includes review of the activities of the former VPRD, who resigned in mid-2003 to take a similar position with the University of North Texas. In July 2005, the University of North Texas placed this individual on administrative leave pending investigations into potential conflicts of interest relating to sponsored research programs. He resigned from his position shortly after. The current VPRD at UM has held the position since August 2003. Several other staffing changes have occurred since 2003. Other senior administrative staff referenced in this report held their positions during the period under review.

The Northern Rockies Consortium for Space Privatization

The NRCSP was a sponsored research program initiated during the tenure of the former VPRD. This program has been the subject of considerable interest regarding the propriety of certain actions conducted or approved by the former VPRD or members of his staff. The following narrative briefly describes the development of the program.

Development of the NRCSP Proposal

The original concept behind the development of the NRCSP was efforts by UM to commercialize space exploration technologies. The university was already involved in several programs where the

Chapter II - Background Information

commercial application of space technologies was being studied. Further contacts with the National Aeronautics and Space Administration (NASA) led to the proposal to pursue grant funding for a research program at UM to encourage education and outreach relating to space-based sciences and technologies.

Efforts to secure NASA funding began in 2002 and involved the former VPRD, members of his staff, and other UM faculty. Throughout the process, the majority of activities concerning the NRCSP grant were managed by the office of the VPRD, rather than by an academic department or affiliated center. By this point, the effort had begun to emphasize the ‘capacity building’ nature of the research proposal and this led to a corresponding de-emphasizing of the technology commercialization activities originally envisioned for the program.

NRCSP Funded Through Congressional Appropriations

UM pursued funding for NRCSP through a direct congressional appropriation (earmarked funding). This was accomplished through line item appropriations inserted in three different congressional bills for federal fiscal years 2003, 2004 and 2005. All these appropriations were directed to space privatization and education efforts at the university and the total amount appropriated was \$4.05 million. Of this total, \$3.3 million was intended to fund activities under the NRCSP grant and the remaining \$750,000 (appropriated for fiscal year 2005), was directed towards a separate space education effort. Following congressional action on the initial appropriation, UM submitted a research proposal to NASA outlining the NRCSP scope of work. The research proposal was submitted in June 2003 and the first funding award was made to UM in September 2003.

Establishment of the Inland Northwest Space Alliance

The establishment of an independent nonprofit entity to deliver a portion of the work under the NRCSP grant was decided at an early stage. Review of UM documentation showed that establishment of INSA was always an integral part of the NRCSP proposal. Further to this, a member of the VPRD staff (an Assistant to the Vice

Chapter II - Background Information

President), was intending to establish the corporation and leave the UM to act as its chief executive officer.

Discussions with current and former UM staff indicate the decision to include INSA as a sub-contractor was driven by direction from NASA and the agency's preference for a private entity to be involved in the research program. It was clear in UM proposals that some of the scope of work would be the responsibility of a private sector entity specifically established for and by this purpose. INSA was formally incorporated in February 2003 and the individual named as the chief executive officer was the UM Assistant to the Vice President referenced above.

Movement of Staff Between UM and INSA

INSA became the primary sub-contractor for the NRCSP grant effective July 1, 2003. Up to and following this date, several members of UM staff from within the office of the VPRD resigned to take up positions with INSA, or subsequently went on to receive compensation from INSA in some form. The following shows the positions of UM staff or faculty who received compensation from INSA after their termination from UM.

- ▶ Assistant to the Vice President for Research and Development became the INSA chief executive officer
- ▶ Director of Support Services in the Office of Sponsored Programs became the INSA business manager.
- ▶ Program Specialist in the Office of Sponsored Programs/International Programs became the INSA director of government relations.
- ▶ The Vice President for Research and Development (former) became an INSA board member/director.

Grant Administration and Expenditures

The NRCSP grant funded additional activities, in addition to those assigned to INSA. Several other sub-contracts were also awarded through the grant for delivery of specific portions of work. As well as the PI, other UM faculty, staff members, and graduate students worked on the research and received compensation. The UM Office of Research and Sponsored Programs was responsible for administrative oversight of grant expenditures and contract matters.

Chapter II - Background Information

The grant PI was responsible for monitoring sub-contractor progress, submission of the required reports to NASA, and for delivery of the final work product. The majority of the research work relating to the NRCSP grant was completed by September 2005. The following table shows expenditures made under the NRCSP grant between 2003 and 2005.

Table 1
NRCSP Grant Expenditures
Calendar Years 2003-2005

<u>Expenditure Category</u>		<u>Amount</u>	<u>Percentage of Total</u>
Personal Services	Salaries and Wages	\$591,702	24 %
	Benefits	\$169,490	
Total Personal Services		\$761,192	
Operating	Consulting & Professional Services	\$47,028	63 %
	Subcontract Payments	\$1,839,099	
	Supplies	\$36,612	
	Communications	\$14,094	
	In-State Travel	\$7,587	
	Out-Of-State Travel	\$40,668	
	Non-Employee Travel	\$10,103	
	Other Travel	\$270	
	Other Expenses & Rent	\$1,188	
Total Operating		\$1,996,649	
Total Capital Equipment Expenditures		\$9,990	--
Total Indirect Costs		\$404,576	13 %
Total Expenditures		\$3,172,407	

Source: Compiled by the Legislative Audit Division from Banner records.

As shown, approximately one quarter of grant expenditures were for salaries and benefits paid to UM employees. These personal services expenditures do not include the salaries and benefits paid to employees of INSA or other sub-contractors working under the grant. Sub-contract payments were included in operating

Chapter II - Background Information

expenditures, which also include consulting and professional services, supplies, communications, travel, and other expenses. Sixty-three percent of total expenditures were operating costs. Remaining grant expenditures were attributable to capital equipment expenditures and indirect costs (universities apply indirect cost rates to all grant awards for support of facilities and administrative costs).

Audit Issues Identified During Review of NRCSP Activities

Concerns relating to the NRCSP grant and the role of INSA included whether the program fulfilled its original mission and whether the grant was managed correctly by UM. Audit work addressed these issues and findings show improvements are necessary in grant management procedures.

NRCSP Statement of Work and Mission Fulfillment

As with all federal research grants, the NRCSP award was based on a research proposal submitted by the university. The proposal outlined the scope of the research and this formed the basis for the statement of work included in the NASA-UM cooperative agreement. Three primary activities were identified:

1. Implement a NASA education and outreach function for the inland Northwest region (specific emphasis on the state of Montana).
2. Enhance and expand NASA data archiving, retrieval and distribution functions.
3. Assist in bringing NASA-developed technologies to full application.

Detailed descriptions of the work products and other deliverables were also included in the cooperative agreement. The sub-contract between UM and INSA also contained provisions outlining the expected results. The majority of the activities conducted under the statement of work for the NRCSP grant were related to education and outreach promoting the NASA mission, and other capacity building projects designed to develop space-related research in the region. Additional effort was directed towards improvements in NASA data management procedures.

Chapter II - Background Information

The origins of the NRCSP proposal can be identified in a broad effort to seek commercial applications for technologies developed as part of space exploration programs administered by NASA. However, as the NRCSP proposal developed, UM had to adapt to changes in NASA priorities as the agency reacted to shifting federal policy directives. As a result, what started out as a space technology commercialization program focused more on education and outreach activities.

Although originally developed as a ‘space privatization’ program, the joint efforts of the NRCSP and INSA do not appear to have significantly furthered the commercialization of space-related technologies in the region. An internal study conducted by the UM business school in 2004 expressed concern about the sustainability of the INSA business model and the ability of INSA to function as an effective mechanism for developing and commercializing space technologies. However, for the majority of the activities outlined in the statement of work, there is evidence that NRCSP delivered in line with the educational and outreach expectations of NASA.

Conclusion: Activities related to the NRCSP grant were consistent with the statement of work agreed with NASA.

Assessing Outcomes for Academic Research

Examination of the work product delivered under the terms of the NRCSP grant illustrates a central dilemma in any review of academic research programs. The process of academic research and scientific discovery can be viewed as a public good, regardless of any collateral benefits arising from the results of the research. The ‘value’ of such research can be seen in the activity itself, rather than any publications, processes, ideas, products, businesses or jobs created as a result. In the scope of our audit work there was never any intention to directly assess the value of the research conducted under the NRCSP grant.

There is, however, a standard approach to assessing the merit of research proposals. The majority of research proposals are subject to a competitive selection process through grantor

Chapter II - Background Information

agencies/organizations. Most of the research conducted in the Montana University System is only funded after a rigorous process of independent peer review and assessment of merit. This competitive process ensures a successful proposal has intrinsic merit as an academic endeavor, as measured against accepted standards. The NRCSP proposal was awarded funds pursuant to an earmarked federal appropriation and was not subject to peer review or other competitive process.

Federal Earmarks and Sponsored Research

Earmarked federal awards are subject to review by federal agencies to ensure the proposed purposes are consistent with the agency's mission. This differs from competitive peer review, which assesses merit from an entirely different perspective. The lack of a competitive selection process for earmarked federal grants should serve as an indicator of potential risk and the need for elevated scrutiny of these activities. The issue of federal earmarking is applicable to all of Montana's institutions of higher education and further discussion of controls over earmarked federal funding will be included in our subsequent report addressing system-wide issues.

UM Should Improve Management of Sponsored Research Activities

In some regards the NRCSP program and the establishment of INSA were a unique circumstance. The NRCSP grant was funded through a federal earmark and was not subject to a competitive selection process. The proposal was conceived and managed through the Vice President's office, rather than through an academic department or university center (as would normally be the case). INSA was not an independent entity already operating outside of the university, but was, essentially, established specifically to fulfill the terms of the NASA grant. INSA was also staffed largely by former UM employees with direct links to the office of the VPRD.

However, the very uniqueness of these circumstances also serves as an indicator of the potentially high level of risk involved in these activities. Mitigating this risk should have been a priority for university administrators, but our review shows several opportunities to do so were missed. The university, either by action or omission, failed to ensure a sufficient level of control was exercised over

Chapter II - Background Information

activities relating to the NRCSP grant. The following chapters contain findings and recommendations developed to address these control deficiencies and assist the university in improving management of these activities.

Chapter III - Disclosure of Research Activities

Introduction

This chapter contains findings relating to the documentation and disclosure of sponsored research activities at The University of Montana (UM). Specifically, audit findings address the administration of the Northern Rockies Consortium for Space Privatization (NRCSP) grant and the sub-contracting arrangements between UM and the Inland Northwest Space Alliance (INSA). Recommendations address management of potential conflicts of interest in sponsored research through improvements in the university's disclosure procedures.

Defining and Managing Conflict of Interest

Conflict of interest is generally defined as a divergence between an individual's public or professional duties and their private interests. In public institutions, a potential conflict of interest exists when an employee or official engages in activities where their private financial or other interests appear to be given priority over their responsibility to uphold the public trust. Actual conflicts of interest are relatively easy to define and identify, and are prohibited under federal and state law. Potential conflicts of interest, however, are both more difficult to identify, and more prevalent. University research and development activities are considered particularly susceptible to conflicts, because of the potential for profitable commercialization. For this reason, mitigating or managing this risk becomes especially important. According to a recent task force study by the American Association of Universities, the first and most important task in managing conflicts is disclosure. This guidance is supported by numerous references in federal law and agency regulations, state law, and Board of Regents policy, where the central principle is 'disclosure first, disclosure always.'

UM Neglected Several Opportunities to Disclose NRCSP Activities

During the administration of the NRCSP grant, several opportunities to fully disclose the nature and extent of the activities were neglected by UM. The following disclosure opportunities are discussed in more detail in subsequent sections:

- ▶ Internal disclosure and review of potential conflicts of interest for UM faculty and staff involved with the NRCSP grant.

Chapter III - Disclosure of Research Activities

- ▶ External review of NRCSP as a research and development program within the university system.
- ▶ External review of the technology transfer aspects of the NRCSP grant and sub-contracting arrangements with INSA.

Internal Disclosure of Conflict of Interest

Internal disclosure is the first line of defense organizations have when managing potential conflicts of interest. Internally, organizations need to have effective policies and procedures in place to ensure potential conflicts of interest are properly identified, disclosed and, where necessary, managed. Our review showed potential conflicts existed with the NRCSP activities, but UM lacked effective procedures for managing the situation.

Potential Conflicts of Interest Existed With NRCSP Activities

Potential conflicts of interest with the NRCSP grant existed because several members of staff within the office of the Vice President for Research and Development (VPRD) went on to work for INSA, the primary grant sub-contractor. Four members of VPRD staff accepted positions at INSA either before or after they resigned from UM, including the Vice President, the Assistant to the Vice President for Research and Development, the Director of Support Services in the Office of Research and Sponsored Programs, and a Program Specialist in the Office of Research and Sponsored Programs. For at least two of these individuals, there was clearly a potential conflict of interest requiring disclosure and management:

1. The Assistant to the Vice President for Research and Development was directly involved in developing the grant proposal at the same time as he was preparing to establish and operate the corporation (INSA) that would eventually benefit as the primary grant sub-contractor.
2. The Vice President for Research and Development had direct supervisory authority over the grant process and at the same time was aware his spouse, the Director for Support Services, had been selected as the business manager of the corporation (INSA) that would eventually benefit as the primary grant sub-contractor.

Disclosure Procedures Should Mitigate Potential Conflicts

According to grant management regulations from the federal Office of Management and Budget, and Board of Regents and The University of Montana policies, the circumstances relevant to these

Chapter III - Disclosure of Research Activities

two individuals qualify as potential conflicts of interest. Disclosure of these conflicts was not documented within the office of the VPRD. Discussions with current UM employees indicate there could have been some form of verbal disclosure, but no record exists to verify this occurred. The only documented disclosure for this grant was made by the Principal Investigator (PI), who signed a disclosure statement, but did not identify either of the two potential conflicts discussed above.

UM Disclosure Documentation Should be Revised

Although the PI is responsible for most aspects of grant administration, it was clear in this circumstance that other individuals with the office of the VPRD were also directly involved in the grant process. Under current procedures, the PI is not required to specifically certify that conflicts of interest do not exist for his/her family members and/or other researchers involved in the proposal. UM disclosure statements make a reference to the university's conflict of interest policies, but there is no requirement that any potential conflict is identified and documented on the university proposal clearance form.

This is in contrast to proposal clearance documentation used by Montana State University, where the PI is required to answer a specific question regarding potential conflicts of interest for themselves personally, their family members, and other people involved in the research. If a potential conflict is identified, the PI is also required to document the approach to managing the situation.

Revising UM proposal clearance documentation to directly address potential conflicts for all relevant individuals could ensure officials responsible for grant oversight and compliance are notified of any potential conflicts. As a counterpart to notification, UM should also ensure the management of potential conflicts is adequately documented. In any situation where a potential conflict is notified, procedures should ensure proposal clearance cannot go forward without a documented explanation of the conflict management plan.

Chapter III - Disclosure of Research Activities

Recommendation #1

We recommend The University of Montana revise procedures to ensure disclosure of potential conflicts of interest in sponsored research are properly documented by:

- A. Revising conflict of interest certification statements/questions on proposal clearance documents; and**
- B. Requiring documented conflict management plans prior to proposal clearance approval.**

UM Conflict Management Procedures Should be Improved

Properly documenting potential conflicts of interest is one important element of disclosure and helps reduce the perception of partiality. Another necessary element is independent review of conflict management. UM conflict management procedures assign this role to the office of the VPRD, which is responsible for ensuring potential conflicts are reviewed and managed effectively. Faculty or staff engaging in sponsored research are required to report potential conflicts to a member of the VPRD staff. Depending on the situation, the potential conflict can be referred to a Conflict of Interest Review Committee (CIRC), consisting of members of faculty appointed by the VPRD.

No CIRC was appointed to review NRCSP activities and there is no evidence the office of the VPRD ever considered establishing a committee. Essentially, the former Vice President was in a position to act as judge and jury on the question of whether he and his direct subordinates had potential conflicts of interest.

In situations where members of staff within the office of the VPRD are directly involved in research activities, disclosure of potential conflicts of interest should be managed independently. As the immediate supervisor, the UM President should be responsible for ensuring research activities of the VPRD and staff within the office are subject to independent review. This could involve appointing a qualified individual to report independently on the potential for conflicts of interest arising from any particular situation.

Chapter III - Disclosure of Research Activities

Additionally, the use of independently-appointed review committees should be considered.

Recommendation #2

We recommend The University of Montana revise procedures to ensure research activities involving members of staff within the office of the Vice President for Research and Development are subject to independent review for potential conflicts of interest.

External Review of University Research and Development Programs

The Montana Constitution assigns the Board of Regents (the board) with overall responsibility for administration of the Montana University System and its constituent campus units. In relation to research and development activities, section 20-25-108 (1), MCA, authorizes universities to engage in research and development programs subject to the prior approval of the board. These statutory provisions raise the question of whether UM should have sought board approval prior to initiating the NRCSP effort.

UM Withdrew NRCSP Activities for Board Review

UM initially submitted activities relating to the NRCSP grant to the September 2003 board meeting. The university requested authorization for the program and the agenda included a brief description of the nature and scope of activities. Board records indicate the NRCSP agenda item was withdrawn by the UM President. Discussions with UM officials indicate the item was withdrawn after the university decided board authorization was not required. According to UM officials, this decision was based on the determination that the NRCSP effort was a grant proposal, rather than a substantive research 'program.' Ordinarily, grant proposals for new or ongoing research would not require board approval. However, a more substantive research and development program, even when based on a single grant, could be subject to direct board oversight. Review of prior board proceedings show a similar research project at Montana State University (the Center for Bio-Inspired NanoMaterials) was submitted for consideration at the July 2003 board meeting.

Chapter III - Disclosure of Research Activities

Given the nature and scope of NRCSP activities, the effort could have qualified as a research program subject to board review. UM originally envisioned a long-term research effort and anticipated building on the initial grant to develop further space-related activities involving several members of faculty and staff from different departments.

Clarifications in Board Review Criteria

Depending on statutory interpretation, the NRCSP research effort could have been subject to board oversight. Given that a similar Montana State University research program was considered and approved at the preceding board meeting, it is unclear why it was necessary to withdraw the NRCSP agenda item. However, criteria available to universities regarding what constitutes a research and development program could be clarified further. Development of such criteria could assist universities in determining which research efforts require board approval. This issue will be addressed in more detail in our subsequent report containing findings applicable to the Montana University System.

External Review of University Technology Transfer Activities

A final opportunity for disclosure of NRCSP activities can be identified in relation to the decision to contract with the Inland Northwest Space Alliance (INSA). INSA was established by and for the purposes of the NRCSP grant and was staffed largely with former UM employees. In some respects, this situation corresponds with technology transfer activity where a university employee works for or starts a business seeking to commercialize intellectual property developed through sponsored research. State law requires board approval for these activities. This external disclosure mechanism ensures independent review of activities and protects participants from the perception of conflict of interest.

Statutory Disclosure Requirements for Technology Transfer Activities

Section 20-25-109, MCA, establishes requirements for university system employees engaging in technology transfer activities. Board review and approval is required before university employees can be employed by business entities seeking to commercialize intellectual property developed through research activities. Intellectual property

Chapter III - Disclosure of Research Activities

is defined broadly to include “economic development” activities, and covers multiple activities where a potential for commercialization exists.

State statute does not authorize technology transfer activities; this is accomplished in federal law, which authorizes commercialization of federally-funded research. State law provides a disclosure mechanism and, as a counterpart, specifically exempts university employees from relevant sections of the state ethics code. These exemptions are necessary because technology transfer activities place university employees in situations where their public and private interests can conflict. The relevant sections of state law, therefore, protect university employees by ensuring their activities are externally reviewed. This review process is a condition of the ethics code exemption granted to university employees and allows technology transfer activities to take place.

UM Considered Board Review of INSA Formation

The formation of INSA does not correspond exactly with the standard definition of a technology transfer activity. However, there are significant similarities between the formation of INSA and activities relating to commercializing intellectual property, which are generally defined as technology transfer. These similarities include building on a base of existing knowledge, expertise and resources within the university; involvement of faculty and other researchers with a background in the subject area; and the establishment of organizations in the private sector that retain close links to the research institution.

The formation of INSA was similar to technology transfer activities and UM should have sought board review. UM Legal Counsel confirmed the university did consider seeking board review, but subsequently decided this was unnecessary. Our review of the circumstances suggests board review of the formation of INSA should have been considered a prudent practice and a suitable mechanism for disclosing these activities to the board. Ultimately, disclosure of these activities should not have jeopardized the success

Chapter III - Disclosure of Research Activities

of the program, provided that no improper or inappropriate actions came to light as a result.

Lack of Disclosure Placed UM Employees in Conflict With State Ethics Code

Based on an opinion from Legislative Audit Division legal counsel, we have determined that certain activities relating to the NRCSP and the formation of INSA may have constituted violations of the state ethics code. The decision by the UM President's office not to externally disclose INSA formation meant the exemptions from state ethics laws normally available for technology transfer activities were not applicable. Certain provisions of the ethics code could be relevant to the formation of INSA. Specifically, provisions establishing 'cooling off' periods for public employees after they leave state employment. During these periods, the former employees cannot benefit from contracts or other actions in which they were directly involved as public servants. These provisions could apply to the former Assistant to the VPRD, who subsequently became the INSA chief executive officer.

Conclusion: Certain activities of former University of Montana staff members relating to the Northern Rockies Consortium for Space Privatization and the Inland Northwest Space Alliance may have constituted violations of the state ethics codes.

Referrals of Potential Ethics Codes Violations

In accordance with our statutory obligations to report potential violations of state laws, we have made referrals to the relevant offices in relation to NRCSP activities. Referrals have been made to the office of the Attorney General and the Commissioner of Political Practices and cite the activities of the former Vice President for Research and Development and the former Assistant to the Vice President. These referrals cite potential violations of the sections of the ethics code addressing cooling off periods for state employees and nepotism.

Chapter IV - Grant Administration

Introduction

This chapter addresses issues relating to the administration of the Northern Rockies Consortium for Space Privatization (NRCSP) grant by The University of Montana (UM). Audit work addressed several different aspects of grant administration, including disclosure of lobbying activities, contract procedures, and sub-recipient monitoring. Findings and recommendations relevant to these issues are discussed in the following sections.

Disclosure of Lobbying Activities

Federal laws and regulations establish restrictions on lobbying activities for recipients of federal grants, contracts, cooperative agreements and other awards/assistance. These restrictions are designed to prevent federal funds from being used to lobby Congress or executive branch agencies for more funds, and to impose lobbying disclosure requirements on organizations that benefit from federal funding. Lobbying reports filed with the United States Senate show the Inland Northwest Space Alliance (INSA) used the lobbying services of Washington D.C.-based lobbying firm during 2004 and 2005.

UM Internal Audit Identified INSA Lobbying Expenditures

INSA had initially submitted approximately \$11,000 in expenditures for lobbying services as part of its indirect cost rate justification required by UM. These expenditures were identified by UM Internal Audit staff and determined to be nonallowable under federal regulations.

As part of the INSA sub-contract, UM included provisions on lobbying disclosure mandated by the National Aeronautics and Space Administration (NASA). These provisions require lobbying disclosures for any activities relating to the contract itself. Review of the applicable federal regulations shows that, in addition to the contract provisions, UM is also required to obtain lobbying disclosures from any lower-tier sub-recipient receiving federal funds in excess of \$100,000. These requirements codify direction from the Office of Management and Budget (OMB) Circular A-110 (Uniform Administrative Requirements for Grants and Other Agreements with Institutions of Higher Education, Hospitals and Other Nonprofit

Chapter IV - Grant Administration

Organizations). OMB guidance establishes the principle of tier-to-tier disclosure, i.e., each sub-recipient at each tier discloses lobbying activities to the tier above. To date, INSA has not submitted a lobbying activity disclosure form to UM relative to the NRCSP grant.

UM Should Revise Lobbying Disclosure Procedures

To comply with federal law and regulations, UM should require disclosure of lobbying activity for lower-tier sub-recipients where the contract cost is in excess of \$100,000. Requiring this disclosure from sub-recipients could also improve the university's ability to detect situations where sub-recipients submit lobbying expenditures as part of justification for indirect costs. Inclusion of such expenditures in the calculation of indirect cost rates could result in violations of federal law and possibly jeopardize future federal awards to the university. In general, sub-recipients for sponsored research activities are other institutions of higher education. These entities already have to file lobbying disclosures with federal agencies. It would, therefore, be reasonable for UM to require lower-tier lobbying disclosure only for private sector organizations.

Recommendation #3

We recommend The University of Montana develop procedures to ensure compliance with lobbying disclosure requirements for all private sector lower-tier sub-recipients receiving federal funds in excess of \$100,000.

Contract Monitoring Procedures

Review of NRCSP grant expenditures included examination of records relating to sub-contracts and consulting services contracts entered into by INSA. INSA sub-contracted with a business to fulfill portions of the scope of work and also had two consulting services agreements with individuals. The following sections address concerns we identified relating to the university's ability to effectively monitor contracting activity for sub-recipients such as INSA.

Approval of Sub-Contracts

It is an accepted practice in sponsored research for grant sub-recipients to sub-contract certain aspects of their assigned tasks to institutions or businesses with specialist knowledge. For the NRCSP grant, some portions of the scope of work assigned to INSA were conducted by a private technology company based in Washington, D.C., under a sub-contract. Federal regulations allow sub-recipients (INSA) to enter into contracts with lower-tier sub-contractors, provided the sub-contractor is specifically identified in the original research proposal. Where a lower-tier sub-contractor is not identified in the original proposal, the sub-recipient must seek authorization from the grantor agency prior to executing a contract. Agency review and approval ensures the contracting process conforms with federal procurement and other relevant compliance standards.

Review of the NRCSP grant file and sub-recipient records for INSA showed no documentation was included indicating the university had verified grantor agency approval of the sub-contract. The main sub-contract agreement was signed effective November 14, 2003, for a total cost of \$225,000. The sub-contractor was not named in the research proposal submitted to NASA, the NASA letter of award, or in the sub-contract between UM and INSA. The first documented indication that the sub-contractor was officially involved in the research was a contract amendment dated March 25, 2005, approximately 17 months after the sub-contract was executed.

UM Should Verify Grantor Agency Approval of Sub-Contracts

For this sub-contract, there is no evidence UM staff verified grantor agency approval prior to paying costs incurred by INSA. Discussions with UM staff indicated the grant Principal Investigator had provided verbal assurances that the sub-contract had been approved by NASA. It appears that the university approved expenditures for the sub-contract based on this verbal assurance. In situations where sub-contracts are not approved by a grantor agency, the university could find itself in breach of the conditions of a federal award for paying such costs to a lower-tier sub-contractor. Taking steps to verify and document pre-approval of sub-contracts could help protect the university from liability associated with improper

Chapter IV - Grant Administration

payments to lower-tier sub-contractors. Principal Investigators are already required to identify any sub-contracts associated with a research proposal. This information could be used to improve procedures within the Office of Research and Sponsored Programs and ensure grantor agency approval of sub-contracts is verified and documented in the grant file.

Recommendation #4

We recommend The University of Montana modify procedures to ensure grantor agency approval of sub-contracts is verified and documented prior to payment of sub-contract costs.

Monitoring of Contracted Services

INSA also entered into consulting services agreements (defined as agreements for contracted services for administrative purposes). These agreements were with a Missoula-based consulting firm and an attorney based in Washington, D.C. Expenditures under these two agreements totaled approximately \$19,000 and \$45,000, respectively. Review of INSA records showed limited information was available regarding vendor selection procedures or the scope of work assigned to the consultants. It was not clear whether INSA followed accepted procurement practices in either bidding these contracts or providing adequate justification for a sole source exception as required under federal regulations.

Grantor agency approval is not required for contracted services and the university is not under any obligation to review contracted services agreements entered into by its sub-recipients. However, the university does have established policies governing procurement procedures for contracted services, which are applied to its own business practices. In sponsored research, the university is most often dealing with other institutions of higher education as sub-recipients for grants. In these cases, UM has substantial assurance that these sub-recipients have procedures in place to ensure contracted services are administered in compliance with accepted procurement standards. For nongovernmental sub-recipients (such as INSA), this assurance is more limited.

UM Should Revise Monitoring Procedures for Nongovernmental Sub-Recipients

Under Office of Management and Budget circular A-133, UM is required to have sub-recipient monitoring procedures in place to ensure lower-tier entities are complying with relevant laws and regulations. For INSA, these procedures included review of the organization's financial statements audit and other measures, but did not include review of procurement policies. For nongovernmental sub-recipients, the university should revise monitoring procedures to ensure compliance with federal procurement standards for competitive bidding and sole source exceptions. This could be achieved by requiring nongovernmental sub-recipients to adopt relevant sections of the university's own procurement policies and integrating review of procurement practices in sub-recipient monitoring procedures.

Recommendation #5

We recommend The University of Montana revise sub-recipient monitoring procedures for nongovernmental entities to obtain assurance of compliance with applicable procurement standards.

University Response



MONTANA UNIVERSITY SYSTEM
Office of the Commissioner of Higher Education

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June 12, 2006

Mr. Scott Seacat
Legislative Auditor
Legislative Audit Division
State Capitol, Room 135
P.O. Box 201705
Helena, MT 59620-1705

RECEIVED
JUN 12 2006
LEGISLATIVE AUDIT DIV.

Dear Mr. Seacat:

On behalf of the Board of Regents and their staff, I express my appreciation for your willingness and that of the Legislative Audit Committee to expand the Performance Audit to include the Northern Rockies Consortium for Space Privatization at the University of Montana. It was fortunate that your staff had already embarked on the Performance Audit of Montana University System Research and was able to extend the scope of the audit to include this important issue.

In light of recommendations from this audit, together with those that may come from the complete performance audit of research and development within the Montana University System, we will carefully review of policies relating to research and development programs. Our goal will be to build on the recommendations from your office, with the goal of providing stronger direction regarding research and grant activities that should require Board of Regents scrutiny and/or approval. We are also looking forward to outcomes from the Legislative Audit system-wide review of MUS research procedures and controls.

Please convey our thanks to the audit team for their work. As always, your staff members handled themselves in a very professional manner in complex and challenging circumstances.

Sincerely,

A handwritten signature in cursive script that reads "Sheila M. Stearns".

Sheila M. Stearns
Commissioner of Higher Education



The University of
Montana

Office of the President
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Missoula, MT 59812-3324

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13 June 2006

Mr. Scott A. Seacat
Legislative Auditor
Legislative Audit Division
Room 135 State Capitol
P. O. Box 201705
Helena, MT 59620-1705

RECEIVED

JUN 13 2006

LEGISLATIVE AUDIT DIV.

Dear Mr. Seacat:

We thank the Legislative Audit staff for their cooperation and completion of The University of Montana special performance audit of The Northern Rockies Consortium for Space Privatization. We found the audit team proceeded very professionally and expeditiously.

We concur with all of the recommendations in the report and University personnel will take the necessary actions to strengthen our controls and procedures. Finally, we will implement all of the revised policies and procedures by the beginning of the next Academic Year.

We appreciate the cooperative efforts made by the audit team and thank those involved for their assistance. We will continue to make improvements and strive to provide accountability and appropriate internal controls in all aspects of our operations.

Sincerely,

George M. Dennison
President

GMD/cc
Denlet3254

c: D. Dwyer, Vice President for Research and Development
S. Stearns, Commissioner of Higher Education

The University of Montana

**Response to Legislative Audit Division
The Northern Rockies Consortium for Space Privatization
June 2006 Performance Audit**

RECOMMENDATION #1

WE RECOMMEND THE UNIVERSITY OF MONTANA REVISE PROCEDURES TO ENSURE DISCLOSURE OF POTENTIAL CONFLICTS OF INTEREST IN SPONSORED RESEARCH ARE PROPERLY DOCUMENTED BY:

- A. REVISING CONFLICT OF INTEREST CERTIFICATION STATEMENTS/QUESTIONS ON PROPOSAL CLEARANCE DOCUMENTS; AND**
- B. REQUIRING DOCUMENTED CONFLICT MANAGEMENT PLANS PRIOR TO PROPOSAL CLEARANCE.**

The University concurs with the recommendation. The University will review and revise the UM Proposal Checklist/ Proposal Clearance form and procedures associated with proposal submission to define conflict of interest disclosure requirements clearly. Office of Research and Sponsored Programs (ORSP) personnel will revise procedures to require an approved conflict management plans where a potential conflict exists. The University will implement these changes beginning on 1 July 2006. In addition, the University will provide appropriate and detailed training beginning in Fall 2006 to University employees on the applicable Conflict of Interest reporting requirements and procedures.

RECOMMENDATION #2

WE RECOMMEND THE UNIVERSITY OF MONTANA REVISE PROCEDURES TO ENSURE RESEARCH ACTIVITIES INVOLVING MEMBERS OF STAFF WITHIN THE OFFICE OF THE VICE PRESIDENT FOR RESEARCH AND DEVELOPMENT ARE SUBJECT TO INDEPENDENT REVIEW OF POTENTIAL CONFLICT OF INTEREST.

The University concurs with the recommendation. University personnel recently identified this weakness in procedures and will revise applicable conflict of interest policies and procedures by September 2006. The University's Research Compliance Officer and Human Resource Services personnel will conduct campus-wide training on the new procedures during Fall 2006.

RECOMMENDATION #3

WE RECOMMEND THE UNIVERSITY OF MONTANA DEVELOP PROCEDURES TO ENSURE COMPLIANCE WITH LOBBYING DISCLOSURE REQUIREMENTS FOR ALL PRIVATE SECTOR LOWER-TIER SUBRECIPIENTS RECEIVING FEDERAL FUNDS IN EXCESS OF \$100,000.

The University concurs with the recommendation. The University will revise current subcontract documents and monitoring procedures to ensure lobbying disclosure in accordance with applicable regulations at all levels. ORSP personnel will also modify procedures to require annual certification/disclosure of lobbying activities from subrecipients and lower-tier subrecipients. The responsible ORSP personnel will implement the revised procedures by 1 September 2006.

RECOMMENDATION #4

WE RECOMMEND THE UNIVERSITY OF MONTANA MODIFY PROCEDURES TO ENSURE GRANTOR AGENCY APPROVAL OF SUBCONTRACTS IS VERIFIED AND DOCUMENTED PRIOR TO PAYMENT OF SUBCONTRACT COST.

The University concurs with the recommendation. The University will modify existing procedures and contract templates to ensure granting agency approval, when applicable, for subcontractors prior to payment. ORSP personnel will implement the modified procedures no later than 1 September 2006.

RECOMMENDATION #5

WE RECOMMEND THE UNIVERSITY OF MONTANA REVISE SUBRECIPIENT MONITORING PROCEDURES FOR NONGOVERNMENTAL ENTITIES TO OBTAIN ASSURANCE OF COMPLIANCE WITH APPLICABLE PROCUREMENT STANDARDS.

The University concurs with the recommendation. The University will modify contract language and procedures to obtain certification from subrecipients of compliance with all applicable regulations including procurement practices. The responsible personnel in ORSP will implement these procedures by 1 September 2006.